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DEPT. OF TRANSPORTATION

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INTERACTIVE TRAVEL SERVICES ASSOCIATION

U.S. Department of Transportation
Room PL-401
400 Seventh Street S.W.
Washington, DC 20590

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RE: Regulation of Computer Reservation Systems /18 -64
Docket Numbers OST-97-2881, OST-97-3014, and OST-98-4775
Comments of the Interactive Travel Services Association

Dear Sir or Madam:

The Interactive Travel Services Association (ITSA) is the trade association for the online travel services industry. The industry is one of the largest segments of electronic commerce today and is growing at an incredible pace. According to PhoCusWright, the online travel industry "is the fastest growing e-commerce category, poised to grow from $7 billion in 1999 to $20.2 billion by 2001." In addition, online travel services represent a rapidly growing share of airline ticket sales. In 1996, less than one-half of one percent of airline tickets were sold through airline Web sites or online travel agencies. Today, online purchases account for an estimated 5.9 percent and are expected to grow to over 11 percent by 2003.

Independent online travel services provide significant benefits to consumers, including: unprecedented access to information upon which to base travel decisions; stimulated market competition and lower airline ticket costs; enhanced consumer services' and improved market efficiency. They also encourage price discounting by suppliers and enhance market penetration by small and start-up airlines.

<u>CONSUMER BENEFITS IN JEOPARDY</u>

ITSA's members have serious concerns about the impact of Orbitz, the proposed airline-owned travel Web site, on competition, innovation, and customer choice. Specifically, the joint ownership of the Web site by the major airlines, and the implicit and explicit agreements that provide Orbitz with *de facto* exclusive access to discount Internet airfares are likely to harm competition and consumers.

Orbitz does not provide any new service or product that is not already available from existing online travel services. Therefore, there are no pro-competitive benefits from this new Web site. There are many Web sites that provide the means to collect and disseminate low fares from nearly all airlines. There are also no efficiencies to be gained by the airlines to justify the airlines' collective action. Instead, Orbitz is an attempt by the airlines, through collective action, to reduce competition from independent online travel agents and, thereby, increase profits.

The investment community has recognized that Orbitz's purpose is to reduce competition. As reported in *The Forrester Brief*, January 24, 2000, "T2 (Orbitz) is not about giving consumers a one-stop shop that they don't already have – online travel agencies already aggregate hundreds of suppliers. Instead, it is designed to cut out Travelocity.com and Expedia, which, if left unchecked, could grow large enough to negotiate better fares and commissions with large suppliers on their own."

EXCLUSIVITY

Limiting Access to Lowest Airfares. The major airlines have stated their intention to reserve Internet fares and special deals to the Orbitz site. Through this means, the joint owners will cut off the supply of discount airfares to competing non-airline owned distributors. This is part of a strategy to develop a Web site that is the "only place to go" for consumers seeking the lowest cost airfares. With its big airline owners effectively boycotting other distribution channels with these lower fares, Orbitz can be expected to draw a significant share of the online travel market. Research has shown that 40 percent of all travelers and over 60 percent of leisure travelers select an online travel service based on price.

The contract between Orbitz and the affiliated airlines provides Orbitz with "special" access (other than on each individual airline's own Web site) to discount airfare information. That the parties contemplate that the contracts will operate with exclusivity as to these fares has been reaffirmed in public statements and testimony before Congress. For example:

- Donald Carty, the Chief Executive Officer of American Airlines, told the Senate Judiciary Committee that some of the offerings made on Orbitz will not be made on other sites. According to Mr. Carty, "It is envisaged by this particular site that some offering will be made on this site that won't be made on other sites, at least by the equity owners of the airlines."
- Orbitz' Chief Technology Officer has stated, "Everyone goes through the same four or five computer reservation systems that all have the same information. These are all publicly available fares. We're getting the same stuff as everyone else, **except that the special fares that are on the Web sites of particular airlines, we are putting in one place to look**." (Emphasis added.)
- Orbitz Airline Charter Associate Agreement (Section 2.2) states, "Airlines shall provide Company (Orbitz) with In-Kind Promotions...implemented in accordance with the valuation methodology in Exhibit B." Exhibit B states, "In-Kind Promotions may include exclusive promotions or fares available on Company (Orbitz) Web site."

The launch consultant for Orbitz is the Boston Consulting Group (BCG). BCG's business model in outlined in the book, *Blown to Bits*. BCG warns that independent Internet distributors are too aligned with the interests of the consumer and advocates taking steps to deny this benefit and return the business advantage to the seller (i.e., airlines). BCG recommends that suppliers, such as airlines, deny critical inputs and inventory to independent distributors:

"Product suppliers [airlines] and traditional retailers alike fear the rise of the agent navigator [Internet distributors independent of suppliers] who facilitate broad reaching comparisons without even being a part to the transaction. However, a component to critical mass for either kind of new navigator is often the incumbent's product information, price list, and willingness to accept business switched through that navigator. This opens the possibility of denying critical mass. If **enough suppliers** refuse to provide information to the dispassionate agent, neither the e-retailer nor the agent can achieve critical mass." (p. 115) (emphasis added)

Finally, while Orbitz argues that there is no requirement that owner airlines boycott other distribution channel with their lowest fares, they have a strong economic incentive to do so. Based on published reports, the major airlines will have invested approximately $500 million in the launch of Orbitz. Offering their lowest fares to other distribution channels would detract from the economic viability of this investment.

Detrimental Impact of This Fare Boycott. This fare boycott will harm airline competition and deny consumers and travel agents access to accurate and complete information on travel services. The major airlines are attempting to subvert the competitive process by jointly deciding where and how the airline industry should distribute a valuable product, its lowest fares. The effect of the carriers' concerted actions will be to reduce innovation and the quality of airline distribution services. In the long run, increased fares will likely result as direct price competition between existing airlines is reduced, and expansion and entry by new carriers who depend on third party channels is impeded.

Orbitz' fare boycott will severely weaken and/or eliminate most online travel services. Industry observers believe Orbitz will quickly become one of the largest online travel sites. Independent Web sites - many of whom have been operating with negative cash flows for a number of years with the expectation of positive earnings as Internet travel matures - have limited wherewithal to withstand the type of major market dislocation that will be occasioned by the Orbitz fare boycott.

Fewer and weaker independent Web sites will provide new entrant carriers with fewer channels to distribute their products. Furthermore, the remaining Web sites would have to severely curtail their ability to engage in innovations, many of which spur price competitions, such as "airport finder" and vacation planning features. As pointed out by the Department of Transportation Inspector General, "If the airline equity owners of Orbitz refuse to make their lowest Internet fares available to online competitors, Orbitz would have a significant marketing advantage that could allow it to achieve a dominant online market share or even eliminate its online competitors...At such a point, with its market power over the airlines established, Orbitz might choose to charge premiums to airlines to participate (i.e., raise costs) rather than offering reduced costs through lower booking fees. Such an outcome would benefit Orbitz' equity partners to the detriment of other participating airlines."

PARITY OR MOST FAVORED NATION (MFN) CLAUSES

The Orbitz contract, in effect, precludes independent negotiations between airlines and travel intermediaries for discount airfares, because the contract includes most favored nation (MFN) clauses and require members to post any special fare offered elsewhere on the Orbitz site. Participating air carriers must give Orbitz access to all published fares, which, under the Orbitz contract, is broadly defined and encompasses virtually every fare in a given airline's inventory, including: (1) any fare published in a CRS, (2) any fares, and corresponding inventory, published in the carriers internal reservation system, (3) Internet fares, including those offered via their own web sites or by e-mail to targeted customers, and (4) fares offered to travel consolidators.

The MFN clause will reduce competition, facilitate collusion, and harm new entrants. Airlines currently negotiate special discounts with either online or brick-and-mortar travel services. In addition, individual carriers, particularly new entrants, seek a competitive advantage by initiating a price reduction in selected markets. Competitors generally match price changes to eliminate any competitive advantage, once these price differences become apparent. By requiring that all fares be posted on the Orbitz site, there is no incentive to negotiate selective discounts or initiate price decreases since they are immediately apparent to competitors and will be matched.

In addition, the MFN clause will reduce innovation and, therefore, service and information to the consumer. The airlines cannot divert their business and promotional efforts to other, more responsive and innovative Internet travel sites without also offering the business to Orbitz. Therefore, Orbitz will have no competitive pressure to innovate and improve. In the context of CRS MFN clauses, the Department of Justice described these clauses as "unresponsive to consumer preferences" and "anticompetitive".

DISTRIBUTION OF FARE INFORMATION

As Orbitz is currently structured, the exclusive access to discount fares in Orbitz will drive neutral distributors out of the market, and the airlines that own the site will obtain rebates on the sales of tickets purchased from Orbitz. Therefore, the airlines will have diminished economic incentive to negotiate deals with independent distributors or to engage in neutral distribution systems, such as the Computer Reservation Systems (CRS). This would, in effect, degrade the information currently available on CRSs, reduce their value and undercut this vital channel for small airlines and online and offline ticket agents.

CONCLUSION

E-commerce business cycles are very short. Given the rapid change in the industry, if is difficult, if not impossible, to address a problem after it occurs. According to the Department of Transportation Inspector General, " History has shown how difficult it is to fix problems with airline competition after they occur. If protections against abuse can be instituted early in the game, mistakes of the past can be avoided."

ITSA firmly believes that innovation and competition are fundamental to the development and success of online travel service. Our members welcome fair competition and believe it has been the driving force behind the investments and improvements made by online travel services to better meet consumer needs. However, we object to unfair competition predicated on the airlines withholding the valuable product of low fares from ITSA members, thus driving business to a web site collectively owned by the nation's largest airlines.

We recognize that exclusive fares on individual airline Web sites can be and often are pro-competitive, and that exclusive offers via third parties offer similar benefits. However, when competitors agree amongst themselves to such exclusivity provisions and agree through MFN clauses to bar other sites from striking similar deals, the likelihood that they will result in the suppression of competition far outweighs any pro-competitive rationale. We also believe the Department would be highly suspicious of an agreement among the five largest horizontal competitors in an industry to stop a form of competition that has been occurring to date - in this case, special promotional sales with third party distributors.

AN EFFECTIVE REMEDY

ITSA urges the Department of Transportation to take the following actions:

1. prohibit the Orbitz owners from offering exclusive access to Internet discount fares (or other fares or customer services) only on Orbitz,

2. require that each Orbitz owner make discount Internet fares (or other fares or customer services) offered on Orbitz available to any third party distributor on commercial reasonable terms, and

3. ban any MFN policies or practices.

By taking these steps, the Department would ensure that consumers continue to have access to independent and unbiased fare information, the industry will continue to innovate to improve customer service, and new entrants and expanding airlines will be able to compete more effectively.

Sincerely,

Antonella Pianalto
Executive Director
Interactive Travel Services Association